



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

OFFICE OF
CHIEF COUNSEL

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INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR: Deputy Area Counsel (TEGE)
Area

FROM: Acting Assistant Chief Counsel CC:TEGE:EOEG:TEB

SUBJECT: /POSTF-161838-02

LEGEND

Tribe =

Golf Course =

Bonds =

This Chief Counsel Advice responds to your memorandum dated January 7, 2002. In accordance with I.R.C. § 6110(k)(3), this Chief Counsel Advice should not be cited as precedent.

ISSUE

Whether construction and operation of the Golf Course by Tribe is an essential governmental function within the meaning of § 7871(e) of the Internal Revenue Code.

CONCLUSION

Although it is likely that construction and operation of golf courses are customary governmental functions, there is an argument that the commercial nature of the Golf Course causes it to be other than an essential governmental function within the meaning of § 7871(e).

FACTS

Tribe is listed as an Indian tribal government in Rev. Proc. 2001-15, 2001-05 I.R.B. 465, which lists Indian tribal governments that are to be treated as states for certain federal tax purposes pursuant to §§ 7701(a)(40) and 7871(a).

As part of managing Tribe's economic affairs and caring for Tribe's general welfare, Tribe used proceeds of the Bonds to finance construction of the Golf Course consisting of . The clubhouse includes locker rooms, , a retail store that sells golf-related items, and a restaurant. The Golf Course, , is open to the general public¹

Tribe represents that it decided to construct the Golf Course to further the economic development of Tribe and to reduce Tribe's dependence on as the primary source of revenue for tribal operations and programs.

Tribe represents that there are a large number of golf courses owned and operated by state and local governments, many of which have facilities comparable to those of the Golf Course. Specifically, it represents that as of 1998 there were 2,645 publically owned, municipal golf courses in the United States.

LAW AND ANALYSIS

Section 7871(a) treats an Indian tribal government as a state for certain specified tax purposes, including § 103, subject to the limitations of § 7871(c). Section 7871(c) provides that § 103(a) shall apply to any obligations, other than, generally, private activity bonds, issued by an Indian tribal government (or a subdivision thereof) only if such obligations are part of an issue substantially all of the proceeds of which are to be used in the exercise of any essential governmental function.

¹ No facts were presented about whether any of the Golf Course facilities were subject to a management agreement or other arrangement that might result in private business use.

Section 7871(c) was added to the Code in 1982.² The Senate version of the Act permitted tribes to issue tax-exempt bonds for industrial or commercial activities to the same extent as state and local governments.³ In conference, the ability of tribes to issue industrial bonds was eliminated. As a result, under the 1982 Act, tribes could only issue bond the proceeds of which "are used in an essential governmental function (such as schools, streets, and sewers)."⁴

Regulations defining essential governmental function for purposes of § 7871(c) were issued in 1984.⁵ Those regulations provide that an essential governmental function of an Indian tribal government is a function of a type that is (1) eligible for funding under 25 U.S.C. 13 and the regulations thereunder, (2) eligible for grants or contracts under 25 U.S.C. 245(f), (g), and (h) and the regulations thereunder, or (3) an essential governmental function under § 115 and the regulations thereunder when conducted by a state or political subdivision.

Section 7871(e), added to the Code in 1987 by § 10632 of the Revenue Act of 1987 (the "1987 Act"), provides that, for purposes of § 7871, the term "essential governmental function" shall not include any function which is not customarily performed by State and local governments with general taxing powers.

The House Bill introducing what became the 1987 Act invalidated the § 7871 regulations to the extent that the regulations were inconsistent with the 1987 Act.⁶ The House Bill was adopted in Conference with the added comment that facilities may be "financed with tax-exempt bonds issued by a tribal government provided that the facility satisfies the 'essential governmental function' standard (i.e., the facility is comparable to facilities that are customarily acquired or constructed and operated by States and local governments)."⁷

Discussing the addition of § 7871(e), the Report of the House Committee on the Budget to the 1987 Act describes the reasons for change as follows:

² Section 202 of the Indian Tribal Governmental Tax Status Act of 1982 (the "1982 Act"), Pub. L. No. 97-473.

³ S. Rep. No. 646, 97th Cong. 2d Sess. 14 (1982).

⁴ H.R. Rep. No. 984, 97th Cong., 2d Sess. 16-17 (1982)

⁵ Section 305.7871-1(d) of the Income Tax Regulations.

⁶ Id. at 1139.

⁷ H.R. Rep. No. 495, 100th Cong., 1st Sess. 1012, n.5 (1987).

The committee is extremely concerned about recent reports of Indian tribal governments issuing tax-exempt bonds for what are substantively interests in commercial and industrial enterprises.⁸

The Report continues:

[W]ith respect to bonds issued by Indian tribal governments, the term essential governmental function does not include any governmental function that is not customarily performed (and financed with governmental tax-exempt bonds) by States and local governments with general taxing powers. For example, issuance of bonds to finance commercial or industrial facilities (e.g., private rental housing, cement factories, or mirror factories) which bonds technically may not be private activity bonds is not included within the scope of the essential governmental function exception.

Additionally, the committee wishes to stress that only those activities that are customarily financed with governmental bonds (e.g., schools, roads, government buildings, etc.) are intended to be within the scope of this exception, notwithstanding that isolated instances of a State or local government issuing bonds for another activity may occur.⁹

The conference agreement followed the House bill with a modification permitting the use of tax-exempt bonds for the "limited exception" of manufacturing facilities on tribal lands to foster "employment opportunities on these tribal lands...."¹⁰

Although, as discussed below, the prevalence of an activity is a critical question in determining whether the activity meets the statutorily mandated "customarily performed" standard of an essential governmental function under § 7871(e), there is also an issue with respect to the nature of the activity. Specifically, there is a question of whether an activity, by reason of being "commercial" in nature, falls outside the intended scope of the statutory standard and, therefore, cannot be financed with tax-exempt bonds under § 7871. Under the facts of this case, this is an issue that warrants consideration.

⁸ H.R. Rep.; No. 391 at 1139.

⁹ H.R. Rep. No. 391, 100th Cong., 1st Sess. 1139 (1987).

¹⁰ H.R. Rep. No. 495 at 1012.

The Golf Course, according to representations by Tribe, is operated for commercial purposes. Tribe, _____, represents that the Golf Course was constructed to further the economic development of Tribe and to reduce Tribe's dependence on _____. No facts are presented to suggest that the Golf Course was intended to meet the recreational needs of Tribe or that it is anything other than a commercial enterprise of Tribe.

In this respect, the probable role of the Golf Course in the community contrasts with that of the more typical golf course developed by a state or local government. Generally, golf courses are developed to enhance the lifestyle of both golfing and non-golfing citizens of the community and perhaps to create jobs. Although these golf courses are generally not limited to use by community members nor are the jobs typically limited to residents of the community, they still are predominately aimed at making the community a more attractive place to live.

Golf Course could be seen as disproportionate when viewed as a community amenity, making the balance between community recreation and commercial implications more significantly tilted toward the latter than is likely to be typical.

The legislative history of § 7871(e) indicates that Congress meant not to include commercial or industrial facilities as essential governmental functions even if such functions were commonly financed with tax-exempt bonds by state or local governments. Based on this legislative history and the representations of Tribe, we think that there is an argument that the Golf Course is a commercial enterprise of Tribe that cannot be financed with tax-exempt bonds.

Tribe argues that the commercial nature of the Golf Course is irrelevant because the only question is whether its construction and operation is an essential governmental function under the customarily standard set forth in § 7871(e). Because Congress did not define the term "customarily" in the statute, we have to determine its meaning. To answer this question, it is helpful to refer to dictionary definitions of the term. Webster's defines the word "customarily" as that which is commonly practiced or usual. It also defines the word "common" to mean widespread, prevalent or occurring frequently. Another meaning given to the word common is usual.¹¹ Black's Law Dictionary defines customarily to mean usually, habitually, or regularly.¹²

¹¹ Webster's II New Riverside University Dictionary 340 (1984).

¹² Black's Law Dictionary 492 (4th ed. 1968).

Congress provided some examples of what it believed were essential governmental functions that were customarily performed by states or local governments. For example, schools, streets and sewers are included (H.R. Rep. No. 984 at 16-17). Also included are roads and government buildings (H.R. Rep. No. 391 at 1139), as well as lodges customarily owned and operated by state park or recreation agencies (H.R. Rep. No. 495 at 1012, n.5).

These examples generally indicate that customarily in the context of § 7871(e) should be given the dictionary meaning of common, prevalent, widespread, or usual. Constructing and operating schools, roads, buildings, and sewers are among the most common of governmental functions across the country and among the most common of functions whose construction activities are financed with tax-exempt bonds.

The state park lodge example illustrates that an activity which is not a prevalent or regular activity of all state or local governments can nevertheless be customary for purposes of § 7871(e) if it is a prevalent or regular activity of state or local government entities that have specific responsibility for the function within which the activity occurs.

Generally, the first step in determining whether an activity is an essential governmental function under § 7871(e) is to understand the universe within which the function occurs, i.e., is the activity a general function that is performed at multiple levels of government or so specialized that it is only performed by one type of state or local government. The construction and operation of roads is a generalized function that is performed by states, counties, municipalities, and special districts. On the other hand, the state lodge example in the legislative history is an illustration of a specialized function that is only performed in state parks. The next step in the inquiry is the degree of prevalence of the function within those jurisdictions where the function is generally performed.

In this case, golf courses are owned and operated by every level of state and local government so the relevant inquiry for the degree of prevalence of golf courses is within all of these state or local governments. Tribe represents that among these governments there were at least 2,645 public golf courses in 1998. This appears to be a significant number and it is probable that the number has grown.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

----- § 1.7871-1(d)(3) defines “essential governmental function” the same under § 7871 and § 115. Congress modified § 1.7871-1(d)(3) but the regulation was not repealed. Thus, there is an argument that for purposes of § 7871, we continue to apply the § 115 standard modified by the customarily requirement imposed by § 7871(e). Generally, under the § 115 standard, there is no specific restriction on commercial enterprises of state or local governments.¹³ Thus, as modified, the only question under § 1.7871(d)(3) may be whether the activity being financed is a customary activity of state or local governments. -----

¹³ Revenue Ruling 77-261, 1977-2 C.B. 45, sets forth the standard generally applied in § 115 cases: "[I]t may be assumed that Congress did not desire in any way to restrict a State's participation in enterprises that might be useful in carrying out those projects desirable from the standpoint of the State government which, on a broad consideration of the question, may be the function of the sovereign to conduct."

Additionally, the commercial restriction discussed above is found only in the legislative history. Although we believe that the meaning of "essential governmental function" in § 7871(e) should be resolved by reference to legislative history, there are principles of statutory construction that suggest definitional ambiguities should be resolved by deferring to the ordinary meaning of the words in the statute. The problem of statutory construction is compounded in this case by the fact that some courts, including the Tenth Circuit ¹⁴, have adopted the principle that federal statutes are to be construed liberally in favor of Native Americans, with ambiguous provisions interpreted to their benefit.

[REDACTED]

[REDACTED]

As indicated above, we are aware that Tribe may have plans to use tax-exempt bonds to finance ----- . No inference should be drawn from this FSA about our conclusions concerning an expanded facility. An expanded facility as we believe Tribe contemplates would be more easily distinguished as a commercial enterprise. Also, it would be less likely that an expanded facility would be comparable to other municipal golf course complexes.

This writing may contain privileged information. Any unauthorized disclosure of this writing may have an adverse effect on privileges, such as the attorney client privilege. If disclosure becomes necessary, please contact this office for our views.

¹⁴ Ramah Navajo Chapter v. Manual Lujan, 112 F.3rd 1455 (10th Cir.1997).

Please call if you have any further questions.

Acting Assistant Chief Counsel
(Exempt Organizations/Employment
Tax/Government Entities)

By _____
Timothy L. Jones
Senior Attorney
Tax Exempt Bond Branch

cc: Division Counsel/Associate Chief Counsel (Tax Exempt and Government
Entities)